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BLACK GOLD OIL & GAS LTD.

STATEMENT OF FINANCIAL STATEMENTS

MARCH 31, 1986

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BLACK GOLD OIL & GAS LTD.

AUDITORS' REPORT AND FINANCIAL STATEMENTS

MARCH 31, 1986

BLACK GOLD OIL & GAS LTD.

INDEX TO THE FINANCIAL STATEMENTS

MARCH 31, 1986

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Company's financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these financial statements present fairly the financial position of the Company as at March 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
June 12, 1986

Touche Ross & Co.
Chartered Accountants

AUDITORS' REPORT

The Shareholders
Black Gold Oil & Gas Ltd.

We have examined the balance sheet of Black Gold Oil & Gas Ltd. as at March 31, 1986 and the statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these financial statements present fairly the financial position of the Company as at March 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
June 13, 1986

Touche Ross & Co.

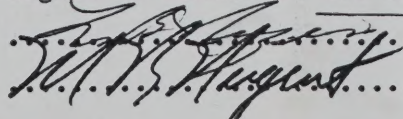
Chartered Accountants

BLACK GOLD OIL & GAS LTD.

BALANCE SHEET AS AT MARCH 31, 1986

| <u>ASSETS</u> | | 1986 | 1985 |
|---|--|--------------------|--------------------|
| Current | | | |
| Accounts receivable (Note 3) | | \$ 124,278 | \$ 267,082 |
| Due from affiliated companies (Note 8) | | 70,483 | 14,680 |
| Inventory of oil, at cost | | 10,626 | 104,322 |
| Prepaid expenses and deposits | | 53,372 | 13,161 |
| Marketable securities, at cost | | - | 55,229 |
| | | <u>258,759</u> | <u>454,474</u> |
| Property, plant and equipment (Notes 2 and 3) | | 5,698,055 | 5,552,709 |
| Drilling deposits and other assets | | <u>22,115</u> | <u>24,235</u> |
| | | <u>\$5,978,929</u> | <u>\$6,031,418</u> |
| <u>LIABILITIES</u> | | | |
| Current | | | |
| Bank indebtedness | | \$ 12,380 | \$ 26,206 |
| Bank loans | | - | 27,000 |
| Accounts payable and accrued liabilities | | 177,069 | 302,384 |
| Long-term debt due within one year (Note 3) | | <u>43,681</u> | <u>149,529</u> |
| | | 233,130 | 505,119 |
| Long-term debt (Note 3) | | <u>3,444,000</u> | <u>3,503,715</u> |
| | | <u>3,677,130</u> | <u>4,008,834</u> |
| <u>SHAREHOLDERS' EQUITY</u> | | | |
| Share capital (Note 4) | | | |
| Authorized | | | |
| 10,000,000 common shares without nominal or par value | | | |
| Unlimited number of preferred shares | | | |
| Issued | | | |
| 3,369,334 common shares (1985 - 3,313,584) | | 1,423,725 | 1,376,325 |
| 794,495 preferred shares, series 1 | | 794,495 | 794,495 |
| Retained earnings (deficit) (Note 4) | | <u>83,579</u> | <u>(148,236)</u> |
| | | <u>2,301,799</u> | <u>2,022,584</u> |
| | | <u>\$5,978,929</u> | <u>\$6,031,418</u> |

Signed on behalf of the Board

..... Director
 Director

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BLACK GOLD OIL & GAS LTD.

STATEMENT OF INCOME AND RETAINED EARNINGS

FOR THE YEAR ENDED MARCH 31, 1986

| | <u>1986</u> | <u>1985</u> |
|---|------------------|---------------------|
| Revenue | | |
| Oil and gas sales net of royalties, revenue taxes and credits (Notes 3 and 5) | \$ 1,953,500 | \$ 2,024,041 |
| Royalties less revenue taxes | <u>21,207</u> | <u>19,687</u> |
| | <u>1,974,707</u> | <u>2,043,728</u> |
| Expenses | | |
| Interest on long-term debt | 411,888 | 475,415 |
| Operating | 597,413 | 727,346 |
| General and administrative | 364,858 | 410,705 |
| Depletion and depreciation | <u>387,312</u> | <u>374,816</u> |
| | <u>1,761,471</u> | <u>1,988,282</u> |
| Income from operations | <u>213,236</u> | <u>55,446</u> |
| Other income (loss) | | |
| Gain (loss) on sale of marketable securities | 5,125 | (598) |
| Miscellaneous | 13,454 | 11,598 |
| Loss on disposal and write-down of property, plant and equipment | <u>-</u> | <u>(174,957)</u> |
| | <u>18,579</u> | <u>(163,957)</u> |
| Income (loss) before provision for income taxes and extraordinary item | 231,815 | (108,511) |
| Provision for income taxes (Note 6) | <u>58,794</u> | <u>-</u> |
| Income (loss) before extraordinary item | 173,021 | (108,511) |
| Extraordinary item | | |
| Recovery of income taxes arising from the utilization of losses carried forward | <u>58,794</u> | <u>-</u> |
| Net income (loss) for the year | 231,815 | (108,511) |
| Deficit at beginning of year | (148,236) | (1,312,255) |
| Elimination of deficit against common share capital and contributed surplus (Note 4) | - | 1,312,255 |
| Dividends | <u>-</u> | <u>(39,725)</u> |
| Retained earnings (deficit) at end of year | <u>\$ 83,579</u> | <u>\$ (148,236)</u> |
| Earnings per common share (Note 7) | | |

BLACK GOLD OIL & GAS LTD.

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED MARCH 31, 1986

| | <u>1986</u> | <u>1985</u> |
|--|--------------------|--------------------|
| Cash provided by operating activities: | | |
| Net income (loss) for the year | \$ 231,815 | \$(108,511) |
| Add (deduct) items not affecting cash | | |
| Depletion and depreciation | 387,312 | 374,816 |
| Amortization of other assets | 2,120 | 2,120 |
| Loss on write-down of property, plant and equipment | - | 174,957 |
| | <u>621,247</u> | <u>443,382</u> |
| Net change in working capital balances other than cash | <u>(92,934)</u> | <u>(130,241)</u> |
| | <u>528,313</u> | <u>313,141</u> |
| Cash provided by (used in) financing activities: | | |
| Issuance of common shares | 47,400 | - |
| Net retirement of long-term debt | (59,715) | - |
| Net proceeds on long-term debt | - | 260,250 |
| Dividends | - | (39,725) |
| | <u>(12,315)</u> | <u>220,525</u> |
| Cash provided by (used in) investing activities: | | |
| Acquisition of property, plant and equipment | (502,172) | (713,035) |
| Proceeds on disposal of property, plant and equipment | - | 76,500 |
| Drilling deposits | - | (2,000) |
| | <u>(502,172)</u> | <u>(638,535)</u> |
| Increase (decrease) in cash and short term deposits | 13,826 | (104,869) |
| Cash and bank indebtedness at beginning of year | <u>(26,206)</u> | <u>78,663</u> |
| Bank indebtedness at end of year | <u>\$ (12,380)</u> | <u>\$ (26,206)</u> |
| Net change in working capital other than cash | | |
| Accounts receivable | \$ 142,804 | \$ (12,513) |
| Due from affiliated company | (55,803) | 37,567 |
| Inventory, net of depletion | 63,210 | (74,831) |
| Prepaid expenses and deposits | (40,211) | (2,744) |
| Marketable securities | 55,229 | (55,229) |
| Bank loan | (27,000) | 27,000 |
| Accounts payable | (125,315) | (95,520) |
| Current portion of long-term debt | <u>(105,848)</u> | <u>46,029</u> |
| | <u>\$ (92,934)</u> | <u>\$(130,241)</u> |

BLACK GOLD OIL & GAS LTD.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED MARCH 31, 1986

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Property, plant and equipmenti) Exploration and development costs - oil and gas properties

The Company follows the full cost method of accounting for exploration and development expenditures, wherein all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, production equipment, geological and geophysical expenditures, rentals on undeveloped properties and costs of drilling productive and non-productive wells. The Company does not capitalize related interest and general and administrative expenses. Proceeds on minor property sales are credited to the net book value of the property and equipment. Gains or losses on major property sales are recognized in the statement of income.

Costs capitalized are depleted and depreciated on the unit of production method based on estimated proven oil and gas reserves as determined by independent petroleum engineers.

ii) Exploration and development costs - mineral properties

All direct costs related to the exploration and development of mineral properties are initially capitalized. Amortization of such costs will be provided for on a straight-line basis over estimated useful lives or by the unit of production method based on estimated recoverable reserves. If it is determined that a project will not attain commercial production, the related costs will be written off.

iii) Depreciation

The Company provides for depreciation of other equipment over the estimated lives of the assets on the declining balance method using rates varying from 10% - 30%.

iv) Government grants

Petroleum incentive grants are recorded in the year earned and are credited against oil and gas properties.

2. PROPERTY, PLANT AND EQUIPMENT

| | 1986 | | | 1985 |
|---------------------------|--|--|--------------------|--------------------|
| | Lower of cost and net realizable value | Accumulated depletion and depreciation | Net | Net |
| <u>Oil and gas</u> | | | | |
| Oil and gas properties | \$4,710,116 | 992,309 | 3,717,807 | 3,727,857 |
| Mineral properties | 361,918 | - | 361,918 | 203,809 |
| Production equipment | 1,805,480 | 337,688 | 1,467,792 | 1,465,850 |
| Oil and gas equipment | 38,600 | 13,896 | 24,704 | 30,880 |
| Other equipment | 85,285 | 26,951 | 58,334 | 56,813 |
| | <u>7,001,399</u> | <u>1,370,844</u> | <u>5,630,555</u> | <u>5,485,209</u> |
| <u>Sand and gravel</u> | | | | |
| Land | 18,000 | - | 18,000 | 18,000 |
| Buildings | 41,500 | - | 41,500 | 41,500 |
| Sand and gravel equipment | 8,000 | - | 8,000 | 8,000 |
| | <u>67,500</u> | <u>-</u> | <u>67,500</u> | <u>67,500</u> |
| | <u>\$7,068,899</u> | <u>\$1,370,844</u> | <u>\$5,698,055</u> | <u>\$5,552,709</u> |

All of the above assets are at cost except for the sand and gravel equipment which is stated at estimated net realizable value.

3. LONG-TERM DEBT

The details of long-term debt are as follows:

| | 1986 | 1985 |
|--|--------------------|--------------------|
| Bank production loan at the bank's prime plus 3/4% with repayment terms as described below. The loan is secured by certain oil and gas properties and book debts of the Company | \$3,444,000 | \$3,500,000 |
| 12 3/4% debenture repayable in varying combined principal and interest payments to July, 1986. The debenture is secured by a first fixed and specific mortgage on sand and gravel properties and a first floating charge on all property, assets and undertakings of the Company | 39,965 | 143,466 |
| Other | <u>3,716</u> | <u>9,778</u> |
| | 3,487,681 | 3,653,244 |
| | <u>43,681</u> | <u>149,529</u> |
| Less due within one year | <u>\$3,444,000</u> | <u>\$3,503,715</u> |

3. LONG-TERM DEBT (Continued)

No principal repayments of the bank loan are required until the next annual loan review date of September 30, 1986. As a result, no portion of the bank production loan has been classified as a current liability.

Maturities of long-term debt in the year 1987 will consist of any repayments that may be required with respect to the bank production loan referred to above.

4. SHARE CAPITAL

a) Common shares

| | <u>1986</u> | <u>1985</u> |
|---|-------------------|-------------------|
| Common shares without nominal or par value | | |
| Authorized 10,000,000 shares | | |
| Issued 3,369,334 shares | | |
| (1985 - 3,313,584) | \$1,376,325 | \$2,615,983 |
| Contributed surplus | - | 72,597 |
| | <hr/> 1,376,325 | <hr/> 2,688,580 |
| Less elimination of deficit | - | 1,312,255 |
| Add shares issued in current year | 47,400 | - |
| | <hr/> \$1,423,725 | <hr/> \$1,376,325 |
| | <hr/> <hr/> | <hr/> <hr/> |

On September 21, 1984, the shareholders approved a resolution to reduce the common share capital and contributed surplus of the Company by \$1,239,658 and \$72,597 respectively, thereby eliminating the deficit as previously reported at March 31, 1984.

As at March 31, 1986 common shares were reserved as follows:

- i) 794,495 shares for conversion of the preferred shares
- ii) 425,000 shares under share option agreement as detailed under paragraph (c) below.

b) Preferred shares

The redeemable cumulative preferred shares, (Series 1) are convertible according to a specified formula, which, in substance, would result in the preferred shareholder receiving sufficient common shares to realize approximately \$794,495 if these common shares were sold immediately subsequent to conversion. As at March 31, 1986, the preferred shares were convertible into common on a share for share basis.

c) Share options

In 1983, the Company approved a share option plan for a senior officer of the Company granting the officer an option to purchase from the Company 300,000 common shares at a price of \$.50 per share. The option expires February 1, 1990 and to date this

4. SHARE CAPITAL (Continued)

c) Share options

In 1985 the Company approved a share option plan for an external consultant, granting the consultant an option to purchase shares from the Company as follows:

1. 50,000 shares at \$.50 per share. The offer expires September 1, 1987 and to date this option has not been exercised.
2. 75,000 shares at twenty percent under the market price at September 1, 1986. The second portion of the option is subject to the approval of the directors prior to September, 1986 and may be exercised in the period September 1, 1986 to September 1, 1988.

5. ALBERTA ROYALTY TAX CREDIT

The Company has recorded Alberta Royalty Tax Credits in the amount of \$90,229 (1985 - \$105,723) which has been treated as a reduction of crown royalties included in oil and gas sales.

6. INCOME TAXES

The Company has losses of approximately \$215,000 which may be carried forward and applied to reduce future years taxable income. These losses are due to expire as follows:

| | |
|------|-----------|
| 1987 | \$ 45,000 |
| 1990 | 3,000 |
| 1991 | 167,000 |

In 1986 the income tax provision differed from amounts that would have resulted had the reported income been subject to federal and provincial statutory tax rates. The differences between the actual amounts provided and that which would have resulted from application of the statutory rates are as follows:

6. INCOME TAXES (Continued)

| | <u>1986</u> | |
|--|------------------|---|
| | <u>Amount</u> | <u>Percentage of pre-tax income</u> |
| Tax computed using combined federal and provincial tax rates | \$ 108,953 | 47.0 |
| Increase (decrease) in income taxes resulting from: | | |
| Non-deductibility of royalties and other payments to the Crown | 117,129 | 50.5 |
| Non-deductibility of depletion, depreciation and amortization | 39,283 | 16.9 |
| Resource allowance | (162,830) | (70.1) |
| Provincial allowance | (42,407) | (18.3) |
| Other | (1,334) | (0.6) |
| | <u>\$ 58,794</u> | <u>25.4</u> |

7. EARNINGS PER COMMON SHARE

| | <u>1986</u> | <u>1985</u> |
|-----------------------------------|-------------|-------------|
| Basic earnings (loss) per share: | | |
| Before extraordinary item | 4.0¢ | (3.3)¢ |
| After extraordinary item | 5.8¢ | (3.3)¢ |
| Fully diluted earnings per share: | | |
| Before extraordinary item | 3.8¢ | (3.3)¢ |
| After extraordinary item | 5.1¢ | (3.3)¢ |

Basic earnings per common share are calculated using earnings available to the common shareholder. Accordingly, dividends on cumulative preferred shares have been deducted from earnings in both 1986 and 1985. Basic earnings per common share is calculated on the weighted average number of shares outstanding in the fiscal year as follows:

| <u>1986</u> | <u>1985</u> |
|-------------|-------------|
| 3,314,806 | 3,313,584 |

Fully diluted earnings per share assumes that maximum share conversions and options were exercised at the beginning of the year, resulting in a base of 4,588,829 shares.

8. RELATED PARTY TRANSACTIONS

In the ordinary course of business the Company participated in the exploration and development of oil and gas properties with an affiliated company. In addition, the Company sold \$14,287 of product and charged \$145,398 of administrative costs to an affiliated company.

9. COMMITMENTS

Lease agreement

The Company entered into an agreement for the rental of office space commencing June 1, 1983. The minimum lease rentals for the term of this agreement are as follows:

| | |
|------|-----------------|
| 1987 | \$45,300 |
| 1988 | <u>7,550</u> |
| | <u>\$52,850</u> |

10. REMUNERATION OF SENIOR OFFICERS AND DIRECTORS

As at March 31, 1986, the Company had five directors, three of whom were officers. Directors' remuneration in each of 1985 and 1986 was nil and the aggregate remuneration of senior officers was \$54,000 (1985 - \$39,000).

11. SUBSEQUENT EVENT

At the special shareholders meeting of April 11, 1986 the Articles of Incorporation were amended to include the following changes to the authorized share capital of the Company:

1. unlimited voting common shares
2. unlimited non-voting common shares
3. unlimited class "B" preferred shares, which may be issued in one or more series

